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TAX FOUNDATION'S VOL. 29, NO. 4 APRIL 1985

TAX·FEATURES

April 30 is Tax Freedom Day!

U.S. Workers Are on the Job 120 Days Just to Pay Taxes

April may be "the cruelest month," as the poet said. But it will not be quite so cruel to U.S. taxpayers this year, say Tax Foundation economists.

Tax Freedom Day 1985 falls in April—on the 30th, and this is only the second year since 1975 that this occasion has occurred by the end of April. (Revised data for 1984 now indicate that Tax Freedom Day fell on April 29 last year.)

Tax Freedom Day is a benchmark calculated by economists at the Washington-based tax watchdog organization to indicate when the average taxpayer would finish fulfilling his responsibilities to Federal, state, and local governments if every dollar earned from January 1 went to the tax man. The trend for this date to move earlier in the calendar has been apparent since 1982, the first year the Reagan tax cuts began to take hold.

The continued phase-in of those tax cuts, coupled with improved economic performance, has continued this tendency, despite several new Federal laws since 1981 that have hiked income and social insurance taxes, and some statutory increases in state-local levies.

The average U.S. taxpayer now works 120 days to get the tax collector off his back. Unpleasant as this situation may seem, for nine of the past ten years the average taxpayer finished the job even later in the year. As recently as 1981, the U.S. taxpayer worked 126 days—until May 6—just to pay his tax bills.

The table below provides further details.

Tax Freedom Day
Selected Years, 1930-1985

Year	Tax Freedom Day
1930	February 13
1940	March 8
1950	April 3
1960	April 17
1970	April 28
1975	April 28
1980	May 4
1981	May 6
1982[a]	May 4
1983	May 1
1984[a]	April 29
1985[b]	April 30

[a] Revised. [b] Forecast.

Uncle Sam Gets 1 Hr. 43 Mins. States-Locals Take 55 Mins.

Federal, state, and local taxes will take a 2-hour 38-minute bite from the average U.S. worker's 8-hour earnings, according to calculations by economists at the Tax Foundation. This is a minute longer than last year, but 5 minutes less than the bite taken by the tax man in 1980, say researchers at the Washington-based tax watchdog organization.

Uncle Sam, as always, takes the lion's share. The American worker must put in 1 hour and 43 minutes to satisfy his obligations to the IRS. State and local governments combined take about half that much time: 55 minutes, to be precise.

Taxes claim more than any other item of expenditure from that 8-hours' worth of work. Housing and household operations are second, requiring 1 hour and 34 minutes. Other major costs are food and tobacco (59 minutes), transportation (42 minutes), and medical care (35 minutes).

Tax Foundation economists note that the 5-minute drop in the tax bite since 1980 has been exactly offset by an equivalent increase in housing costs. Medical care also claims 5 additional minutes of the workday's earnings, while food (including tobacco) and clothing have dropped 6 minutes and 1 minute, respectively.

The table below supplies details.

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Tax Bite in the Eight-Hour Day and Tax Freedom Day
1980-1985

Item	1980	1981	1982[b]	1983	1984[b]	1985[c]
Taxes	2:43	2:45	2:42	2:39	2:37	2:38
Federal	1:49	1:52	1:47	1:43	1:42	1:43
State and local	:54	:53	:55	:56	:55	:55
Food and tobacco	1:05	1:03	1:05	1:04	:58	:59
Housing and household operation	1:29	1:28	1:35	1:36	1:33	1:34
Clothing	:22	:21	:22	:22	:22	:21
Transportation	:42	:41	:42	:42	:42	:42
Medical care	:30	:30	:34	:34	:35	:35
Recreation	:19	:19	:20	:20	:20	:20
All other[a]	:50	:54	:40	:43	:53	:51
Tax Freedom Day:	**May 4**	**May 6**	**May 4**	**May 1**	**April 29**	**April 30**

[a] Includes personal care, personal business, private education and research, religious and welfare activities, net foreign travel, and net savings.
[b] Revised.
[c] Forecast.
Source: Tax Foundation, derived from data supplied by U.S. Department of Commerce, Bureau of Economic Analysis.

Estimated Total and Per Capita Federal Tax Burdens, by State
Fiscal Years 1984-1986

State	Total burden (millions)			Per capita burden			State rank 1985	
	1984	1985	1986	1984	1985	1986	Total	Per capita
TOTAL	$645,043	$714,248	$770,423	$2,738	$3,010	$3,216	—	—
Alabama	8,276	9,158	9,852	2,094	2,312	2,477	25	46
Alaska	2,266	2,506	2,700	4,340	4,556	4,647	44	1
Arizona	7,257	8,050	8,699	2,365	2,562	2,699	27	36
Arkansas	4,557	5,044	5,426	1,960	2,165	2,318	33	49
California	77,503	85,800	92,607	3,012	3,282	3,480	1	10
Colorado	9,450	10,481	11,330	2,911	3,158	3,331	23	12
Connecticut	11,873	13,156	14,222	3,807	4,218	4,552	19	3
Delaware	1,845	2,042	2,201	3,050	3,364	3,614	48	9
Florida	29,189	32,366	34,978	2,630	2,844	2,991	6	27
Georgia	13,523	14,993	16,184	2,325	2,548	2,714	13	37
Hawaii	2,813	3,114	3,360	2,694	2,941	3,119	38	25
Idaho	2,062	2,281	2,454	2,056	2,250	2,390	45	47
Illinois	34,703	38,386	41,365	3,045	3,373	3,633	4	8
Indiana	13,620	15,080	16,250	2,517	2,797	3,019	12	29
Iowa	7,164	7,929	8,544	2,498	2,775	2,997	28	31
Kansas	6,954	7,700	8,305	2,859	3,152	3,376	29	13
Kentucky	7,770	8,596	9,248	2,100	2,320	2,487	26	44
Louisiana	11,023	12,207	13,163	2,439	2,665	2,830	21	34
Maine	2,489	2,753	2,961	2,174	2,401	2,568	42	41
Maryland	13,477	14,946	16,162	3,131	3,461	3,724	14	6
Massachusetts	18,155	20,094	21,669	3,175	3,519	3,794	10	5
Michigan	24,014	26,562	28,600	2,708	3,024	3,280	9	21
Minnesota	11,307	12,527	13,515	2,735	3,024	3,251	20	20
Mississippi	4,610	5,106	5,499	1,777	1,959	2,096	32	51
Missouri	12,820	14,200	15,313	2,594	2,872	3,091	16	26
Montana	1,948	2,158	2,324	2,364	2,597	2,767	46	35
Nebraska	4,009	4,443	4,798	2,515	2,782	2,991	35	30
Nevada	2,677	2,960	3,187	2,866	3,073	3,203	40	17
New Hampshire	2,767	3,068	3,316	2,855	3,137	3,353	39	14
New Jersey	26,956	29,848	32,206	3,624	4,008	4,312	8	4
New Mexico	3,137	3,478	3,752	2,180	2,371	2,503	37	42
New York	53,579	59,306	64,001	3,056	3,387	3,653	2	7
North Carolina	13,478	14,934	16,106	2,199	2,418	2,584	15	40
North Dakota	1,859	2,053	2,208	2,706	2,958	3,145	47	23
Ohio	28,197	31,204	33,631	2,660	2,957	3,196	7	24
Oklahoma	8,692	9,634	10,401	2,544	2,754	2,900	24	32
Oregon	6,546	7,242	7,792	2,472	2,734	2,936	31	33
Pennsylvania	31,941	35,322	38,024	2,712	3,006	3,238	5	22
Rhode Island	2,635	2,912	3,132	2,777	3,072	3,300	41	18
South Carolina	6,662	7,380	7,953	2,014	2,207	2,349	30	48
South Dakota	1,478	1,638	1,767	2,117	2,347	2,521	50	43
Tennessee	10,670	11,806	12,706	2,278	2,513	2,691	22	38
Texas	46,162	51,193	55,355	2,813	3,035	3,186	3	19
Utah	3,384	3,745	4,031	2,000	2,151	2,247	36	50
Vermont	1,184	1,310	1,410	2,246	2,476	2,645	51	39
Virginia	15,802	17,499	18,879	2,822	3,099	3,309	11	16
Washington	12,607	13,955	15,045	2,901	3,182	3,392	17	11
West Virginia	4,088	4,519	4,858	2,095	2,317	2,489	34	45
Wisconsin	12,019	13,303	14,335	2,545	2,817	3,031	18	28
Wyoming	1,540	1,706	1,839	2,889	3,125	3,283	49	15
District of Columbia	2,310	2,557	2,759	3,799	4,247	4,621	43	2

Source: U.S. total taxes as shown in the Federal budget submitted February 1985; computations of total and per capita tax burdens by state were made by Tax Foundation.

Tax Features

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CA, NY, TX Top Payers Of Federal Tax Bill

Federal taxes will hit $714,248 billion in the current fiscal year (1985), according to Tax Foundation economists. The Administration's 1986 Budget as presented to Congress on February 4 projects an increase of $69.2 billion (10.7 percent) over the $645,043 billion collected in 1984. Federal tax revenues for fiscal 1986 are projected to climb by $56.2 billion (7.9 percent) over 1985 levels. The burden falls unevenly upon the states.

California, New York, and Texas lead the pack again in the current fiscal year for the questionable distinction of having the largest Federal tax burdens in the nation. Predictably, the total dollar amounts taken in by Uncle Sam tend to be highest in states with the largest populations, explain Tax Foundation analysts.

Citizens in the ten states with the heaviest total tax burdens will pay over 57 percent of all Federal taxes, even though they have less than 54 percent of the population. These "top ten" pay about $410.1 billion of all Federal taxes collected. Ranked in descending order of total Federal tax burden, they are:

CA	$85.8 billion
NY	$59.3 billion
TX	$51.2 billion
IL	$38.4 billion
PA	$35.3 billion
FL	$32.4 billion
OH	$31.2 billion
NJ	$29.8 billion
MI	$26.6 billion
MA	$20.1 billion

Except for Massachusetts, the ten states with heaviest burdens are also among the top ten in population.

Sharply contrasting with the huge tax load of the "top ten" states is the tax burden borne by the lowest ten. The following contain about 3 percent of the population and will bear 3 percent of the Federal tax burden ($21.1 billion) in fiscal year 1985:

ME	$2.8 billion
DC	$2.6 billion
AK	$2.5 billion
ID	$2.3 billion
MT	$2.2 billion
ND	$2.1 billion
DE	$2.0 billion
WY	$1.7 billion
SD	$1.6 billion
VT	$1.3 billion

Except for Idaho and Maine, the ten states with lowest total tax burdens rank in the ten states with the fewest residents.

On the other hand, per capita tax burdens tend to hit hardest in states with relatively high average income levels. In fiscal year 1985, residents in the ten states with the highest per capita tax burdens will pay approximately 37.6 percent of the tax bill, about $268.6 billion. Their average Federal tax burden will be $3,471, about 15 percent higher than the national average of $3,010. Those residing in the ten states with the lowest

(Continued on page 4)

$6,346 Federal Tax Bill for $26K Earner

The Federal government is spending an estimated $959.1 billion in fiscal year 1985. For a moderate-income family—one worker earning $26,000 solely from wages with a spouse and two dependent children—this will mean a tax bill of $6,346, according to Tax Foundation economists.

As spending approaches the trillion-dollar range, the place of the ordinary taxpayer in the system may be hard to visualize. To provide some perspective, analysts at the Foundation break down the Federal spending in terms relating to the tax bill of this $26,000-a-year family.

"Income security" is the most costly item among all functions. This includes social security and Federal employee retirement and disability, unemployment insurance, housing assistance, food and nutrition assistance, and other programs. Uncle Sam will lay out a total of $318.3 billion for these items. For the $26,000 earner, the cost is $2,038. In other words, for each $1 this taxpayer sends to Washington, the Federal government will pay out 32 cents for "income security" programs.

(Continued on page 4)

THE FRONT BURNER

By Robert C. Brown
President
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"Hacking Through the Tax Law Jungle"

"Would you tell me, please, which way I ought to go from here?" asked Alice.

"That depends a good deal on where you want to get to," said the Cat.

"I don't much care where—" said Alice.

"Then it doesn't matter which way you go," said the Cat.

That, in a nutshell, characterizes U.S. tax policy in the last five years: an elected leadership with no clearly defined policy goals stages random revenue forays into whatever sector of the taxpaying community seems most vulnerable and least likely to mount an effective counter-offensive. Not knowing where it wants to go, the national government has gone for the gold—seeking short-term revenue gains to keep deficits from becoming even larger. The result—in terms of efficiency, consistency, and simplicity in the tax system of the nation—has been a disaster.

Not that the current generation of legislators is unique. Certainty has been hard to come by since the beginning. The first income tax law, Section II of the Simmons Tariff Act (HR 3321) in 1913, took 16 pages and 8,000 words to nail down what was essentially a 1 percent base tax on taxable income above $4,000 a year, plus an additional tax starting at 1 percent at $20,000 and progressing up to 6 percent on income over $500,000 a year, for a maximum rate of 7 percent.

The quest for certainty has been sharply downhill ever since, and uncertainty now rules the land. Today's Internal Revenue Code is a legislative jungle of 3,000 pages and an estimated 1.5 million words.

To make the system fairer, to raise more revenue, and to further "desirable" social goals, lawmakers have enacted a raft of tax laws in the last 72 years. The early pace—one major tax law every four years or so—created complexity but at least allowed some degree of certainty during the first 25 years under the Code.

The Sixties and Seventies saw 11 major laws in 16 years, raising uncertainty to a kind of art. Then came the Eighties—major tax action every year with each law more complex than its predecessor.

This would be merely ludicrous if the nation's economic life were not disrupted. But consider this:

- Whether through fear of making a mistake for which they will be penalized or of paying tax that some change has made unnecessary, an increasing number of Americans are turning to tax preparers.
- For their part, preparers can no longer be certain that their interpretations of the tax maze are correct.
- The Internal Revenue Service is in a state of gridlock, as more than 450 rules, some dating back to 1978, await decisions.
- State legislatures find their constitutional power to raise revenues impeded, as the impact of Federal laws on their rule-making grows cloudier by the year.
- Corporate America reels from the need to adjust and readjust as revenue and social policy driven alterations turn the Code into an indecipherable crazy-quilt.

These are just some of the conclusions in a recent Tax Foundation thought-starter entitled "Tax Uncertainty: As American as Apple Pie." I recommend it for your reading. Maybe it will upset you enough that you will add your voice to the chorus calling for Washington to straighten out the mess that the Tax Code has become—and then leave it alone for a good long time.

Editor's note: Copies of "Tax Uncertainty: As American as Apple Pie" are available for $2.50 from the Tax Foundation. Please add $1 for postage and handling per order.

"Corporate America reels from the need to adjust and readjust as revenue and social policy driven alterations turn the Code into an indecipherable crazy-quilt."

(FEDERAL TAX BURDEN, from page 2)

per capita tax burdens will pay $50.9 billion, or 7.1 percent of the total. Their average tax burden works out to $2,233 per person, about 25 percent below the national average.

"Top Per Capita"		"Bottom Per Capita"	
AK	$4,556	NM	$2,371
DC	$4,247	SD	$2,347
CT	$4,218	KY	$2,320
NJ	$4,008	WV	$2,317
MA	$3,519	AL	$2,312
MD	$3,461	ID	$2,250
NY	$3,387	SC	$2,207
IL	$3,373	AR	$2,165
DE	$3,364	UT	$2,151
CA	$3,282	MS	$1,959

Tax Foundation procedures for deriving these state estimates have been in use for more than 25 years and state tax burdens are updated annually. The listing is designed to show where Federal tax dollars actually originate, rather than where they are collected. By contrast, U.S. Treasury figures, which show where taxes are collected, do not purport to provide a picture of the state-by-state impact of Federal taxation, according to Tax Foundation economists.

An example of how the two methodologies differ appears in comparison of data related to the collection of Federal excise taxes on tobacco products. Treasury data show these taxes as collected mainly in a few southern states. However, Tax Foundation economists point out that the burden of these taxes may be assumed to fall on consumers of these products in all states, so that collections data published by Treasury do not show who is actually bearing the burden of these taxes.

The table on page 2 provides further details.

"Altogether, direct and indirect Federal taxes claim over 24 percent of this family's annual income."

How the Federal Government Will Spend A Worker's Tax Dollars in Fiscal 1985[a]

Function	Worker's share: Amount	Worker's share: Percent of total	Total spending (millions)
Income security[b]	$2,038	32.11	$318,347
National defense	1,624	25.60	253,830
Net interest	835	13.16	130,426
Health[c]	641	10.10	100,135
Education, training, employment, and social services	195	3.07	30,434
Transportation	173	2.72	26,994
Veterans' benefits and services	172	2.71	26,850
Agriculture	129	2.03	20,165
International affairs	126	1.98	19,583
Natural resources and environment	83	1.31	13,024
General science, space, and technology	56	.88	8,740
Community and regional development	55	.86	8,553
Energy	52	.82	8,164
Administration of justice	43	.67	6,686
General purpose fiscal assistance	42	.66	6,552
Commerce and housing credit	38	.60	5,987
General government	37	.58	5,782
Allowances and contingencies	7	.11	1,131
Total	$6,346	100.00	$959,085[d]
Exhibit:			
Payments for individuals	$2,735	43.10	$427,332

[a]In this example, the worker is the sole source of support for a spouse and two dependent children, and earns $26,000 per year. Government spending includes budget and off-budget items.
[b]Includes social security, Federal employee retirement, unemployment compensation, housing assistance, food and nutrition assistance; excludes veterans' income security.
[c]Includes medicare, medicaid, and others; excludes veterans' hospital and medical care.
[d]After deducting $32,296 million in undistributed offsetting receipts not classified by function.
Source: Tax Foundation computations, based on Federal Budget presented February 4, 1985 (Office of Management and Budget) and tax laws from Treasury Department.

June Conference Planned

A tax policy conference on "Tax Reform Implications for International Business" will be sponsored by the Tax Foundation on Tuesday, June 4, 1985, in Washington, D.C. at the Washington Plaza Hotel.

Topics to be discussed at the conference will include proposed changes in the foreign tax credit and Section 936 applying to Puerto Rico.

Details on speakers and registration will appear in the May issue of *Tax Features*, or please call the Tax Foundation.

(WORKER'S TAX DOLLARS, from page 3)

National defense will claim $253.8 billion in Federal outlays this year, or 26 cents out of each tax dollar. For the moderate-income taxpayer described here, this amounts to $1,624. The third most expensive item is interest on the public debt. Net interest in 1985 will cost $130.4 billion; for this worker, the tab will be $835, over 13 cents per dollar of taxes. Health outlays, totaling more than $100.1 billion, will cost the moderate-income family $641, or 10 cents for each tax dollar paid.

These four big programs account for more than 80 percent of all Federal spending. Other functional programs that will cost the moderate-income taxpayer over $100 in 1985 are: education, training, employment, and social services ($195); transportation ($173); veterans' benefits and services ($172); agriculture ($129); and international affairs ($126). The costs of the remaining functional programs are shown in the accompanying table.

Foundation analysts call attention to another category of major Federal spending that cuts across functional lines as classified in the budget. This is "payments for individuals." In 1985 these payments will add up to $427.3 billion. For this moderate-income family, the cost is $2,735, or 43 cents of every tax dollar. Included in this classification are the income security items shown above; payments for veterans; assistance to students; health and medical care under medicare and medicaid and other programs; and other payments to individuals under special programs.

The money to support government programs comes from taxes, nontaxes, and borrowing. The individual income tax provides the biggest share of the tax money. For this $26,000-a-year family, the income tax will take $2,137 from annual earnings. Social security taxes divert another $1,833 to Uncle Sam. Direct levies account for only about three-fifths of the Federal tax take, according to Tax Foundation analysts. To these must be added a number of indirect taxes—employer's share of social security taxes; corporate income taxes; excise taxes on such items as gasoline, liquor and tobacco; and miscellaneous levies. These indirect taxes take another $2,376 from the moderate earner's paycheck.

Altogether, direct and indirect Federal taxes claim over 24 percent of this family's annual income. But that's not the whole story.

In addition to paying a big slice of current earnings for taxes, the family must assume a share of the $222.2 billion fiscal 1985 deficit. For the family described here, that burden is an additional $1,974. All told, current Federal taxes and borrowing add up to $8,320, or 32 percent of this moderate-income family's earnings.

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TAX FOUNDATION'S VOL. 29, NO. 5 MAY 1985

TAX·FEATURES

Highest Earning Half of Population Pays 90% of All Federal Income Taxes

Nation's Tax Bill Now Measures Nearly Five Times '67 Level

The Tax Index climbed to a new high of 496.6 in the fourth quarter of 1984 (1967 = 100), as the nation's total tax bill came to nearly five times the levels recorded for the base year 1967, according to Tax Foundation economists.

Federal, state, and local taxes during the quarter, the latest for which data are available, were collected at a rate that would total $1.090 trillion if continued for one year, reflecting a 9.6 percent annual rate of increase over the previous quarter.

The fourth quarter's rise was 2.5 percentage points (35 percent) higher than the concurrent 7.1 percent annual rate gain in the Gross National Product (GNP), the gross market value of the nation's output of goods and services. (Inflation-adjusted GNP rose 4.3 percent and general prices, 2.8 percent.)

The Tax Index is a fiscal yardstick designed by Tax Foundation economists to provide a continuing current measure of trends in taxes, on a basis comparable to official indexes for other segments of the economy.

Since the trough of the recession (fourth quarter 1982), the Tax Index has risen from 416.4 to 496.6 (1967 = 100), or 19.3 percent. Federal taxes have gone up just under 19 percent, and state-local taxes by over 20 percent. The rise in the Tax Index has been slightly less than the almost 21 percent gain in GNP over the same period.

(Continued on page 2)

Distribution of Federal income tax burdens among higher and lower income earners has been remarkably stable in recent years, despite major statutory changes affecting taxes at all income levels, according to Tax Foundation economists. Analysis of data for tax year 1983, recently released by the Treasury Department, reveals that the top-earning half of the population pays more than 90 percent of the Federal income tax bill. Earners in the top one-tenth pay over half of the bill.

These proportions were almost the same in 1983 as in 1978, Tax Foundation analysis reveals. There has been a tendency, however, for those at the upper end of the income scale to pay an increasing share of the individual income tax. The top 5 percent of income earners in 1983 shouldered 37.9 percent of the tax bill in 1983, up from 34.8 percent in 1978, according to Tax Foundation computations.

Federal individual income taxes totaled $276.1 billion in 1983. Over $257 billion—93.1 percent—was paid by the top 50 percent of earners—represented by the 48 million returns with incomes of $14,888 or more. This group paid an averge tax of $5,339. Five years earlier, the upper half of taxpayers paid 93.5 percent of the taxes.

The 9.6 million taxpayers in the top ten percent grouping shouldered 50.3 percent of all U.S. personal income taxes in 1983—a shade more than their 49.6 percent share in 1978. In 1983, this group had adjusted gross incomes of $41,501 or more, with an average tax burden of $14,419.

The highest five percent of earners in 1983 had adjusted gross incomes averaging $53,066 or more, and paid an average tax of $21,704.

Taxpayers in the lower half of the earning scale—those making $14,887 or less—paid only 6.9 percent of Federal income taxes in 1983, with an average tax of $396. Their share of the tax bill was up slightly from 6.5 percent in 1978.

For all filers, the average tax per return in 1983 was $2,867, an increase of 36.7 percent from 1978.

During the same five-year period there was a sharp increase in the

(Continued on page 2)

Federal Income Taxes Paid by High- and Low-Income Taxpayers
1978 and 1983

Adjusted gross income class	Income level		Percent of tax paid		Average tax	
	1978	1983	1978	1983	1978	1983
Highest 5 percent	$41,850 or more	$53,066 or more	34.8	37.9	$14,608	$21,704
Highest 10 percent	29,428 or more	41,501 or more	49.6	50.3	10,405	14,419
Highest 25 percent	19,937 or more	27,806 or more	73.6	73.4	6,170	8,420
Highest 50 percent	10,972 or more	14,888 or more	93.5	93.1	3,921	5,339
Lowest 50 percent	10,971 or less	14,887 or less	6.5	6.9	273	396
Lowest 25 percent	5,047 or less	6,882 or less	.4	.6	33	72
Lowest 10 percent	1,933 or less	2,723 or less	(a)	(a)	9	12

(a) Less than .05 percent.
Source: Tax Foundation computations based on Treasury Department data.

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"The 9.6 million taxpayers in the top ten percent grouping shouldered 50.3 percent of all U.S. personal income taxes in 1983."

Tax Index and Related Measures
Annually, and Quarterly at Seasonally Adjusted Annual Rates, 1967 = 100
Selected Periods, 1975-1984

Calendar year and quarter	Tax Index			Output Index[a]		
	Total	Federal	State and local	Current prices	Constant prices	Price Index[b]
Annually						
1975	204.3	191.0	232.1	193.8	122.0	158.8
1976	234.0	220.7	261.7	214.9	128.4	167.4
1977	263.1	249.7	291.1	239.9	135.4	177.1
1978	296.2	287.3	314.8	270.6	142.2	190.3
1979	331.5	328.4	338.0	302.4	146.3	206.7
1980	361.2	359.0	365.9	329.1	145.8	225.7
1981	411.9	414.6	406.2	369.9	149.5	247.4
1982	417.1	408.1	435.8	383.9	146.3	262.3
1983	441.3	424.2	476.9	413.3	151.7	272.4
1984	484.6	466.1	523.3	458.3	162.1	282.6
Quarterly						
1982 I	416.0	412.4	423.4	378.4	146.7	258.0
II	420.0	414.2	432.0	382.8	146.4	261.5
III	415.8	403.4	441.7	385.2	146.0	263.8
IV	416.4	402.3	445.9	388.9	146.2	266.0
1983 I	424.2	410.3	453.0	396.9	147.4	269.2
II	443.2	429.8	471.1	408.6	150.8	271.0
III	443.8	423.4	486.3	418.5	153.3	273.1
IV	453.8	433.1	496.8	429.2	155.5	276.0
1984 I	472.4	454.2	510.3	444.4	159.3	279.0
II	483.3	465.8	519.7	455.8	162.0	281.3
III	485.7	466.9	524.9	462.1	162.7	284.0
IV	496.6	477.1	537.2	470.8	164.6	286.0

[a]Gross national product.
[b]Implicit price deflator for gross national product.
Source: Tax Foundation computations and estimates based on data from U.S. Department of Commerce, Bureau of Economic Analysis.

Currently Available

Flatter Taxes and Fatter Bases: An Evaluation of Current Proposals, Special Report, February 1985, 28 p., $10.00 ($7.50, members).

Tax Uncertainty: As American As Apple Pie, Special Report, May 1985, $2.50.

Federal Finances—A Two-Way Squeeze, *Proceedings* of Tax Foundation's 36th National Conference, December 1984, 38 p., $8.00.

State Taxation and Business Climate, Research Bibliography No. 71, February 1985, 10 p., $4.00.

At Issue: Is Corporate Investment Income Taxed Too Lightly?, by Jack F. Bennett, *Fiscal Policy Forum*, Winter 1985, 4 p., $1.00

State Income Taxation of Multinational Corporations, *Proceedings* of a Tax Foundation Seminar, May 1984, 35 p., $15.00 ($12.00, members).

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(TAX INDEX, from page 1)

Among the separate components of the Tax Index, the corporate profits index has scored the largest percentage gain since the 1981-1982 recession bottomed out in the fourth quarter of 1982. The corporate profits tax index has climbed by 61 percent. Its rate of growth was followed by an increase of 23 percent in the social insurance taxes index; 19 percent in indirect business taxes (property, sales, selective excises); 11 percent in the personal income tax index; and 6 percent in the index for all other taxes.

Measured against the 1967 base year, contributions for social insurance have outpaced all other types of taxes, reaching a fourth quarter 1984 index of 728.3. The Federal index, 741.5, is running somewhat ahead of the state-local index of 658.2.

The next highest growth since 1967 has occurred in personal income taxes, which reached an index of 547.0 in the latest quarter reported. State-local personal income taxes are now more than 10 times their 1967 base, at an index of 1,044.2. The Federal index for personal income taxes has almost quintupled, rising to 498.4. These trends reflect a long-time tendency for state-local personal income taxes to grow relative to those in the Federal sector; in 1967 personal income taxes of subnational levels of government were less than 10 percent of the amounts collected by the Federal government. By the fourth quarter of 1984, state-local personal income taxes were more than 20 percent of the Federal personal income tax take.

A similar disparity has taken place in the corporate sector of the Tax Index. The overall index in the fourth quarter of 1984 stood at 272.2 percent of the 1967 base, reflecting a moderate 231.8 index at the Federal level, in contrast to a 762.0 index for states and localities. This differential rate means that state-local corporate profits taxes have risen from about 8 percent of the Federal sector's taxes in 1967 to almost 27 percent currently.

At an overall index of 420.4 percent of the 1967 base, indirect business taxes have also been rising more rapidly at the state-local level. The state-local index of 465 in the fourth quarter of 1984 compares with an index of 311.7 at the Federal level.

The index for all other taxes combined, which covers estate and gift and personal property levies, has shown more restrained growth, reaching a 254.4 index in the final quarter of 1984.

The accompanying table provides additional details for the Tax Index and its Federal and state-local components, in comparison with trends in output.

Fall Seminar Planned

A Tax Foundation Seminar on the taxing of fringe benefits will be held on **Tuesday, September 10, 1985, in Atlanta, Georgia,** at the Ritz-Carlton Hotel—Buckhead.

Further details and reservation information will appear in *Tax Features* or call the Tax Foundation at 202/822-9050.

(HIGH/LOW EARNERS, from page 1)

number of persons with adjusted gross incomes of $1,000,000 or more. There were 11,526 taxpayers in this top group in 1983, up nearly six times from 2,041 in 1978. They paid an average 1983 tax of $886,774 (almost 50 percent of taxable income).

The table on page 1 provides further details.

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FEDERAL TAX POLICY MEMO

MAY 1985

Editor: Edward A. Sprague, Vice President–Tax and Economic Affairs

Some Second Thoughts on Indexing

Some Tax Foundation members will recall our Federal Tax Policy Memo *which was issued as a separate publication on a regular basis from 1978 to 1982 and sporadically since then. We have decided to revive this piece and extend its circulation by including it as an insert in most issues of* Tax Features.

As indicated by its title, Federal Tax Policy Memo *will focus on current tax issues in an analytical and hopefully understandable manner. We will go light on the statistical tables although not promising never to use them. We hope to provide some useful observations on tax reform, tax burdens, budget policy and other such matters that the Congress and Treasury are, and will be, grappling with in our capital city. Reader suggestions and comments are most welcome and may be addressed to the Editor,* Federal Tax Policy Memo.

This year marks the start of indexing the Federal personal income tax for inflation. The rate brackets and personal exemptions are now adjusted to remove the effect of inflation as measured by the increase in the consumer price index (CPI) from October 1983—September 1984 over the previous 12-month period. That means a 4.1 percent factor applying to 1985 withholding tables as of January 1, 1985.

As reported in the November-December 1984 *Tax Features*, indexing is expected to save individual taxpayers $8-10 billion in calendar 1985, with the largest percentage benefit going to middle-income taxpayers. The dragon of bracket creep has been slain! Presumably there is some rejoicing in the ranks.

In the meantime, the Treasury Department has been busy putting together a plan for vast expansion of tax indexing throughout the economy for capital gains, interest, depreciation and inventories. The revenue impact of such indexing would be very substantial even if inflation itself remains in the relatively modest 4-5 percent per year range. The revenue impact, of course, must be considered in the context of base-broadening measures in the reform plan designed to increase revenues and balance the overall program.

Over on the budget expenditure side there are new efforts to restrain the cost of indexing entitlement programs. The Administration/Senate budget proposal for fiscal 1986 for the first time would set across-the-board limits on automatic benefit increases under Social Security and Federal entitlement programs—in effect, reducing the inflation adjustment by two percentage points. The cumulative impact of this for fiscal 1986-88 would be budget savings of approximately $28 billion (with the inflation trend projection of about 4 percent a year under the Administration's original budget assumptions). Already, of course, there are instant warnings of hundreds of thousands of elderly being thrown back under the poverty line and other political rumblings that could derail such a bold move. But the logic of restraint here is compelling—both in terms of the deficit problem and sound long-term policy. Eventually, it should prevail.

Indexing for entitlement benefits and indexing for taxes have distinctly different rationales. The former is a deliberate attempt to shield a segment of the population—mainly retirees—from the effects of inflation. The latter aims to correct for the *unintended* impact of inflation interacting with the progressive rate structure of the income tax and historic measurement of income. More broadly, tax indexing aims to eliminate the unlegislated tax increase that has occurred because of the interaction of inflation and the tax structure, thus forcing Congress to make more explicit policy decisions with regard to both taxes and expenditures. Supporters of indexing refer to it as an "honesty in budgeting tool." But, particularly if inflation adjustment limits are set for entitlements to bring them under better budget control, new questions are going to be asked about the extent of tax indexing, too.

CPI Minus Two

There was proposed legislation in the 98th Congress to limit the Social Security and Federal retirement cost-of-living adjustments (COLAs) to inflation rates *above* the first two or three percentage points of the CPI. There have been repeated proposals to delay COLA adjustments for six months or even a year. The mechanics of the present proposal give a little better break to beneficiaries by guaranteeing a two percent inflation adjustment and allowing almost full adjustment if inflation reignites to double digits but continuing the restraint program over a more sustained period. This would result in quite significant future budget savings regardless of the specific rate of inflation (assuming it will stay above three percent). The projected COLA savings in fact are the single largest item in the Administration/Senate deficit reduction plan next to reduction in defense from the earlier budget base line.

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The longer term financing problems of Social Security were addressed by the 1983 legislation which increased payroll taxes and made some payments to beneficiaries indirectly subject to income tax liability. But we clearly have run out the string on payroll tax increases to keep the system actuarially sound. Fortunately, this is not a problem for OASDI right now. In fact, the OASDI funds are building substantial surpluses and these surpluses, being invested in Federal securities, help absorb a significant part of the Federal deficit. The cumulative effect of a limit on COLA adjustments would be felt in all future years continuing to help build the fund surplus or even holding forth the future opportunity for lower payroll taxes. Don't hold your breath on that, but at least relief from any further rate increase in this obnoxious tax on employment—and serious obstacle to new hiring—should be most welcome.

Finally, there is still substantial doubt that the CPI accurately measures the impact of national inflation on the economic welfare of consumers. Most likely that effect is still exaggerated by the CPI, lacking as it does, any up-to-date means of reflecting the substitution effect. As prices rise—and particularly if they rise sharply as in the late 1970s—consumers typically revise their specific market choices eliminating frills on some items and switching to substitutes of roughly equal economic value but where prices are lower or increase in price is less marked. Even though the market basket of CPI items is periodically revised, there is simply no way to measure this constant substitution in a national index used for so many critical purposes. Two percentage points of the rate probably is a pretty good proxy, however, particularly at four percent or more inflation. In double-digit inflation the substitution effect is undoubtedly larger. But in any event, the latest CPI-minus-two proposal for limiting COLAs would seem to represent as fair as possible a reflection. At very low rates of inflation there is little substitution, and there would be a two percent COLA anyway. If inflation heats up, beneficiaries would still be protected from all but a small part of the nationally reported inflation rate.

Tax Indexing—Should The Train Slow Down?

The bet here is that if we do get an effective limit on entitlement COLAs, the same thing will be applied to indexing of the personal income tax in short order. The elemental politics of the situation would seem to dictate this, not to mention the potential budget savings.

But even while the Treasury has been proposing an expansion of tax indexing throughout the economy, there are other good reasons for going slow on the overall concept. One is fairly obvious. If through tax reform we do achieve a significant reduction and compression of the individual rate structure bringing the top rate down to at least 35 percent and enacting a sizable increase in the personal exemption at the same time, there would be less concern about bracket creep, regardless of the inflation rate and the extent of indexing. It would simply be less important. In fact, the Bradley-Gephardt reform proposal would repeal the personal income tax indexing, thereby picking up some revenue to balance the rate reductions in future years.

Indexing on the Business Side

On the business side, Treasury makes its case for indexing depreciation, capital gains, interest and inventories mainly on the basis of better measurement of income and removing the distorting effects of inflation from investment decisions. There is certainly some economic justification for this approach which could become more compelling if inflation really heats up again. But there are also a lot of practical problems involved, including serious problems in tax planning. At this writing, the specific recommendations of Treasury II are not known, but our working assumption is that the indexing proposals will be cut back. Congress seems unlikely to agree to interest indexing in any event. Significantly, interest indexing according to the original Treasury plan would be a large revenue loser because of the $5,000 exemption from indexing interest deductions of individuals and as long as the private sector as a whole remains in a large net creditor position. Treasury estimates the revenue impact for both individual and corporate sectors at −$18 billion in the first full year of effect. What will evolve for depreciation and capital gains indexing will depend largely on the extent to which modifications are made in the basic depreciation proposal (Real Cost Recovery System) and whether or not capital gains are to be treated as ordinary income.

Tax indexing may well be making a contribution to more open and explicit budget decisions. Congress can no longer hide behind the hidden tax of inflation, at least as it operates through the personal tax structure. But there remains a good deal of uneasiness about it. Does insulating more and more of the private sector from inflation really make for better economic performance or will the primary result be to relax our guard against inflation by making it easier to live with? This is still a very good question even with "modest" inflation around 4 percent.

Since 1979 the monetary authorities have made a strong commitment to anti-inflationary policy. This has more than offset loose budget policy and reduced inflationary pressure in the economy. It would be a shame, to say the least, if the price of that policy, including the sharpest postwar recession on record, were to have been paid in vain.

****

The Minimum Tax

It probably was inevitable. Once Congress got seriously involved with the unpleasant business of budget reductions, it surely would start scratching around for less unpleasant alternatives; and high on that list, as usual, is a minimum tax on corporations. What better way to pluck the goose with the least effective squawking? Current talk is of a stiff new minimum tax that would raise $5–$10 billion a year from "economic income" of the corporate sector that allegedly does not pay its fair share of taxes now. There is also talk of tightening the minimum tax on upper income individuals to raise new revenues and discourage tax shelters.

A minimum tax can be crafted in several ways. It can be a true alternative tax such as is now applied to individuals whereby the taxpayer pays the higher of the regular or minimum tax. Or it can be an add-on tax such as the present corporate minimum tax whereby the taxpayer is allowed deductions from the minimum tax base such as regular tax liability, but still could end up with liability for both minimum and regular taxes. In the typical minimum tax proposal now being discussed, the tax base is composed of regular taxable income plus "preference items" which currently are not subject to tax in whole or in part. Credits usually are not allowed against minimum tax liability except for the foreign tax credit. The result tends to diminish the value of the preferences for some taxpayers but not for others if it is a true alternative tax or there is a large enough deduction for regular tax payments. However it is done, the minimum tax inevitably becomes a messy and complicated feature of the Code. Simplification it is not.

The Present Corporate Minimum Tax

The present corporate minimum tax adds back into the base such items as the excess of accelerated over straight-line depreciation, the preference for long-term capital gains, the excess of depletion deductions over the basis of property, and a few others. Approximately ten thousand corporations now pay the minimum tax, but virtually all other large corporations must compute it anyway to make sure they do not have any tax liability. The new proposals mostly would build on this approach by adding more preference items to the base and stiffening its impact. Most, however, are proposed as an alternative tax rather than the add-on form. Typical of them is S.956 introduced by Senators Daniel Patrick Moynihan (D-NY) and John H. Chafee (R-RI), which would impose a 15 percent alternative tax on corporate income above $100,000, including in the base 22 so-called preference items such as accelerated depreciation in excess of "economic" depreciation, research and experimental expenditures, intangible drilling costs and the tax benefit in the use of the completed contract method of accounting. This bill also would set up a stiffer new alternative minimum tax on individuals with income over $50,000.

Significantly, some changes under the 1984 Deficit Reduction Act (DEFRA) have helped set the stage for new minimum tax proposals. That act redefined the calculation of earnings and profits (E & P) of corporations to sweep in more "economic" income and make it more difficult for corporations to declare non-taxable dividend distributions. Several of the preference income items in new minimum tax proposals are so defined by simple reference to the new E & P rules which, of course, greatly speed up the drafting chore. In addition, the new E & P base also makes for a handy reference for new taxes generally on the corporate sector. One such proposal is S.953 by Senators George J. Mitchell (D-ME) and Chafee which would set a low rate tax on all large corporations based on corporate E & P to help finance industrial pollution cleanup. This corporate "contribution" to the superfund would be made whether or not the taxpayer had any responsibility for pollution.

Diminished Corporate Tax Share

The continuing interest in the minimum tax is driven in large part by the barrage of comment and criticism as to the shrinking share of Federal receipts paid by the corporate sector in income taxes. This is a long-term phenomenon, of course. Pre-World War II, the Federal corporate income tax generally provided more revenue than the individual income tax and even in the late 1950s accounted for about 30 percent of all receipts. Since then the corporate income tax share has shrunk fairly steadily to a low of 6 percent in fiscal 1983 before rebounding to an estimated 10 percent, with the recovery in corporate profits in fiscal 1985. The long-term decline is associated with two trends having nothing to do with corporate tax policy: a corresponding secular downtrend in gross corporate profit margins (profits as a percent of national income) and the very sharp rise in Federal payroll taxes displacing the relative importance of all income taxes. Then too there have been more liberal capital recovery and other provisions which certainly have whittled away at the corporate tax base especially in recent years. In absolute dollars Federal corporate tax receipts have risen substantially with only business cycle interruption, to an estimated new peak of $74 billion in fiscal 1985.

None of this really should have much bearing on what the corporate tax burden should be. As corporations themselves are incapable of bearing the real incidence of any tax, the decision to impose taxes on the corporate form should stem from considerations of effi-

ciency and limiting the shelter opportunities of individuals. In the public perception, however, the corporate sector is getting away with murder, and this is reinforced by press stories on corporations with significant "economic income" but little or no tax liability.

A Flawed Concept

Superficially the corporate minimum tax may seem to be an attractive way to make a dent in the deficit and at the same time attempt a fairer distribution of corporate tax liability. But the concept is flawed. The existing minimum tax was brought into the Code as an afterthought by a Senate amendment to the 1969 Tax Reform Act without any serious consideration as to its place in the corporate tax structure. The original Treasury papers and studies which gave rise to most of the provisions of the 1969 Act recommended *against* a corporate minimum tax on the basis that it could not take into consideration the particular circumstances and problems of different economic sectors calling for particular tax treatment. That is precisely the problem with the existing minimum tax which has had most of its impact on companies and industries with low earnings in depressed markets.

Even if one is taken with a notion of enforcing a fairer distribution of corporate tax liability, the minimum tax approach could have a capricious and uneven impact. Its revenue yield to a large extent could depend on retroactive application to most investments entered into without calculation of a minimum tax liability. In some minimum tax plans the foreign tax credit is allowed as a full offset against the minimum tax. In others it is not, even though the purpose of the credit is to avoid double taxation of earnings and it is not considered a preference income item by tax professionals. Virtually all minimum tax proposals would add back into the minimum tax base part of the Accelerated Cost Recovery System (ACRS) depreciation deduction, either the excess of ACRS over straight line or over "economic" depreciation. This would diminish the utility of ACRS without posing an alternative depreciation system.

No True Solution

A minimum tax addresses all of the add-back items indirectly almost stealthily, robbing them of the intended full impact without confronting squarely the issue of their need in terms of national policy objectives. This is the antithesis of meaningful tax reform and, of course, hardly squares with the simplification objective of reform.

All of the major tax reform proposals under current consideration would make substantial changes in the business tax provisions affected by the typical minimum tax proposals. Some interests, of course, may feel they would be better off with the partial hit of the minimum tax rather than the full bore of tax reform. Others see the minimum tax as more politically attractive. But the reform plans attempt at least to come to grips with the reasons for the particular tax provisions proposing modifications or alternatives, particularly in the areas of capital recovery, capital gains and foreign source income. The reform plans also offer the inducement of significantly lower rates. Both the original Treasury plan and the Bradley-Gephardt plan, incidentally, would repeal the existing corporate minimum tax as a redundant and unnecessary complication of the Code.

Pace of Federal Grants Slows Sharply Since '81

The Federal government disbursed $92.8 billion in grants-in-aid to state and local governments in fiscal year 1984, 4.5 percent ($4.0 billion) more than in fiscal 1983, according to Tax Foundation economists.

After growing at annual rates averaging 15 percent during the 1970s, the pace of grant giving has slowed sharply since 1981. Fiscal 1984 levels were only about $218 million higher than in 1981. (This fact highlights the lasting impact of a $7.0 billion reduction in grants-in-aid from 1981 to 1982—part of a spending rollback unprecedented in recent peacetime history.)

The Administration projects modest growth in fiscal 1985, followed by significant reductions in future years, say analysts at the Washington-based tax watchdog organization.

Medicaid, interstate highway construction, Aid to Families with Dependent Children, subsidized housing, and general revenue-sharing comprised the five largest Federal grant programs in 1984. Together they accounted for more than 51 percent of the grants disbursed, a total of $47.8 billion.

Residents of 19 states, whose Federal tax burdens exceeded the amount of grants received by their respective state and local governments, footed the bill for the

(Continued on page 4)

THE FRONT BURNER

By Robert C. Brown
President
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"With All Deliberate Speed . . ."

From the perspective of those interested in legislative efficiency, the 99th Congress seems to have hit the ground stumbling. When President Reagan delayed publication of his Budget for Fiscal Year 1986, Senate Majority Leader Robert Dole (R-KS) declared that he would have a budget ready for a vote on February 8.

February 8, March 8, April 8, and May 8 came and went. Still no Budget vote. Finally, in the early morning hours of May 10, the Senate committed itself of a budget compromise promising $56 billion in savings next year and about $100 billion over three years—within the limits being touted as a must to reassure a jittery financial community that Washington is serious about getting its fiscal act together.

The proposal arrived with the usual melodramatics and hoopla. Presidential phone calls to wavering Senators. A rush back to Washington by Vice President Bush, whose tie-breaking vote was, indeed, needed. There was even an extra fillip of drama—part Mack Sennett and part "Profiles in Courage"—as an ambulance brought convalescent Senator Pete Wilson (R-CA) from Bethesda Naval Hospital to beef up the ranks of supporters. Wilson, recovering from emergency surgery for removal of a ruptured appendix, arrived on the Senate floor in a wheelchair to a round of applause and cheers from his healthier colleagues.

As is customary, the Senate program spreads a thin veneer of painful cuts over the widest possible population and leaves most of the pork in the barrel, lest any constituency leave the table too hungry. But it was a start on essential fiscal restraint.

The House must now, of course, do its ritual dance. The members must walk the tightrope of loyalty to their own constituencies on the one side and appear not to stand in the way of much needed deficit reduction on the other. We can assume there will be an equivalent amount of "Sturm und Drang" but hope that, like a Wagnerian opera, the Valkyrie of fiscal responsibility finally will ride to the rescue—probably in another late-night, "Perils-of-Pauline" climax.

If this weren't so important, it would be ludicrous.

However, let's not be too judgmental when the U.S. Congress acts like the Katzenjammer Kids. After all, our Founding Fathers could have pushed through a strong central government. Some of them favored naming George Washington king in the heyday of his victory over Cornwallis.

Instead, they took the approach that a government is best when it governs least. Their first solution—the Articles of Confederation—managed the common affairs of the new nation so poorly that our progenitors had to sit in plenary session yet again and hammer out our present Constitution.

Hence, it is no accident that the national government stumbles and bumbles, hems and haws. The patriots who threw off the yoke of one tyrant (to borrow their own view of what they had done) deliberately created a Federal system that would be hard put to ride roughshod over their future generations—ever.

When tempted to berate the people we have elected to lead us, it is well to remember that we get the kind of government that we deserve. It is also well to recall that dictatorship is the most efficient form of government. Given that choice, I'll take inefficiency any day.

"The Senate program spreads a thin veneer of painful cuts over the widest possible population and leaves most of the pork in the barrel."